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No. 04-1046

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In the

Supreme Court of the United States

TOWNSHIP OF UPPER MORELAND,

Petitioner,

v.

NORTHWOOD CONSTRUCTION COMPANY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Pennsylvania

BRIEF IN OPPOSITION FOR RESPONDENT NORTHWOOD CONSTRUCTION COMPANY

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QUESTIONS PRESENTED

1. Whether the Supreme Court of Pennsylvania correctly held that an unapportioned local gross receipts tax which reaches beyond the portion of value fairly attributable to the taxpayer's economic activity within the taxing jurisdiction is not externally consistent under the fair apportionment prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

2. Whether a state court may require a local taxing authority to implement some apportionment formula for imposing a business privilege tax upon the gross receipts of a taxpayer that conducts substantial activity in interstate commerce outside the taxing jurisdiction so that the tax is fairly apportioned.

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COUNTERSTATEMENT OF THE CASE

Respondent, Northwood Construction Company, Inc. ("Northwood"), is a business corporation that performs construction management and general contracting services. 2a.[1] It has been stipulated that Northwood conducts its business activities in Pennsylvania, New Jersey, Delaware and Maryland, with as much as 55% of its annual gross receipts attributable to business activities conducted outside Pennsylvania during the tax years at issue. 2a, 27a. Despite this fact, Petitioner, the Township of Upper Moreland (the "Township"), asserts that taxation of 100% of Northwood's gross receipts pursuant to the Township's Business Privilege Tax Ordinance (the "Ordinance") does not violate the Commerce Clause of the United States Constitution.

While Northwood's principal place of business is within the Township in Willow Grove, Pennsylvania, for each of its construction projects, Northwood establishes and maintains on-site trailer facilities which serve as field offices. 4a n.1. On-site facilities may be maintained for a period of years and have all the amenities of any office, including phone, utility, fax and copier services, offices and conference rooms. *Id.* The facilities are used for the benefit of employees, customers, vendors and suppliers, and are required to manage the full time employees and construction activities of the specific projects. *Id.* These facilities are critical to Northwood's business activities outside the Township, both intrastate and interstate.

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[1] Numeric citations followed by the letter "a", *i.e.* 1a, refer to the Appendix to the Petition for a Writ of Certiorari.

The Ordinance imposes a business privilege tax ("BPT") upon the gross receipts of any person "engaging in business in the Township." Ordinance § 1.04, 64a. The Ordinance provides for the creation of a method for allocating a taxpayer's gross receipts (the "Allocation Regulations") to comply with the Commerce Clause. Ordinance § 1.02, 61a-62a. The Allocation Regulations apply only to taxpayers having offices in more than one state. Ordinance Appendix F, 74a. The Township's position is that Northwood's on-site facilities are not *bona fide* offices, and the Allocation Regulations therefore do not apply. 23a n.13. Rather, based upon Northwood's maintenance of a principal place of business in the Township and its use of on-site facilities to conduct and manage its business outside Pennsylvania, the Township taxes 100% of Northwood's gross receipts.

The Ordinance excludes from the Township's BPT gross receipts "upon which a business privilege tax or similar tax has been imposed by another political subdivision by reason of the performance of the service or conducting the business in that political subdivision" (the "Exclusionary Provision"). Ordinance § 102(f)(4), 60a. It is undisputed that Northwood pays taxes based upon its gross receipts/net income attributable to other states based upon its on-site facilities and economic activities within those states. 27a n.18, 30a n.19, 31a n.20. However, these taxes are paid at the state level, and Northwood receives no credit for them because the Township interprets its Exclusionary Provision to apply only to taxes paid to political *subdivisions*. 27a n.18.

These same on-site facilities which the Township claims are not *bona fide* offices that would trigger the Ordinance's Allocation Regulations do in fact subject Northwood to BPTs and similar taxes in other municipalities within Pennsylvania. 6a-7a. Based upon Northwood's facilities and

economic activities in other Pennsylvania municipalities, Northwood is considered to be "doing business" within those municipalities and taxed appropriately. *Id.* Pursuant to the Ordinance's Exclusionary Provision, the Township gives Northwood credit for these intrastate taxes. 6a, 7a n.5, 36a-37a.

Northwood challenged the Township's taxation of 100% of its gross receipts as unconstitutional under the Commerce Clause and the test established by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), to evaluate the constitutionality of state and local taxes. 9a, 39a-40a, 48a. The Pennsylvania Supreme Court held that the Ordinance violates the Commerce Clause because it is not fairly apportioned as required by *Complete Auto*. 19a. Specifically, the court concluded that the Ordinance is not "externally consistent" since, by subjecting 100% of Northwood's gross receipts to its BPT, the Township is plainly taxing more than that portion of the revenues from Northwood's interstate activities which is fairly attributable to the privilege of maintaining an office in the Township. 30a-31a.

REASONS FOR DENYING THE WRIT

This case presents a straightforward and correct application of the test this Court established almost thirty years ago in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), to evaluate the constitutionality of a state or local tax under the Commerce Clause. A tax fails the *Complete Auto* analysis unless it: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the benefits provided by the state. *Id.* The Pennsylvania Supreme Court held that the Township's Ordinance is unconstitutional because it is not externally consistent and thus not fairly apportioned. 31a. Because it determined that the Ordinance fails the second prong of the *Complete Auto* test, the court did not address the third and fourth prongs. 19a. Northwood submits that the Ordinance also fails these prongs.[2]

The petition does not meet any of this Court's criteria for a grant of certiorari. The Township has pointed to no prior decision of this Court which presents any legitimate conflict with the decision below. The Pennsylvania Supreme Court and other state courts have properly interpreted this Court's precedents concerning the constitutional

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[2] The Pennsylvania Supreme Court held that if the Township were to apply the Exclusionary Provision of its Ordinance, the Ordinance would be internally consistent as also required by the fair apportionment prong of *Complete Auto*. 24a-26a. However, the court's analysis assumed that the Exclusionary Provision would be applied to give credit for taxes paid at the state as well as the local level. 25a. The Township does not so apply the Exclusionary Provision, *see* 27a n.18, and Northwood submits that the Ordinance is not internally consistent as it is applied.

requirements for gross receipts taxes, and those precedents were correctly applied to the particular facts presented here. The Pennsylvania Supreme Court correctly held that in taxing Northwood's gross receipts the Township is required to make an apportionment between receipts attributable to Northwood's local office and receipts from its out-of-state business. Contrary to the Township's suggestion, it retains complete discretion as to the specific constitutional apportionment formula it may adopt going forward.

A. The Pennsylvania Supreme Court and Other State Courts Have Correctly Applied This Court's Precedents Concerning the Fair Apportionment Requirements for State and Local Gross Receipts Taxes Mandated by the Commerce Clause.

In an effort to create an appearance of confusion that might warrant this Court's intervention, the Township suggests that the decision below and other state decisions invalidating unapportioned gross receipts taxes have erroneously relied upon *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995), a sales tax case. Pet. at 8. To the contrary, in determining that the Township's BPT is not externally consistent the Pennsylvania Supreme Court did not misread *Jefferson Lines*, which discusses gross receipts taxes as well as sales taxes, nor have other state courts.

In *Jefferson Lines*, 514 U.S. at 190-91, this Court upheld an unapportioned Oklahoma sales tax, distinguishing it from a superficially similar unapportioned New York gross receipts tax that was struck down in *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 660 (1948). The Court's application of the external consistency test to the two taxes was the critical distinguishing factor between them.

The external consistency test evaluates whether the taxing authority's claim upon the value taxed is economically justified and asks whether a tax reaches beyond that portion of value fairly attributable to the taxpayer's economic activity within the taxing jurisdiction. *See, e.g. Hunt-Wesson, Inc. v. Franchise Tax Board of California*, 528 U.S. 458, 464 (2000); *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989). In contrast, the internal consistency test looks at the tax's structure and determines whether multiple taxation would occur if every state applied the identical scheme. *Goldberg*, 488 U.S. at 261. Although the Township claims that the distinction between the two tests is becoming "blurred," Pet. at 9, this Court, the Pennsylvania Supreme Court, and other state courts continue to apply them separately. *See Jefferson Lines*, 514 U.S. at 184-85; 19a, 26a; *City of Winchester v. American Woodmark Corp.*, 471 S.E.2d 495, 497 (Va. 1996); *Southern Pacific Transp. Co. v. Arizona*, 44 P.3d 1006, 1010 (Ariz. Ct. App. 2002).

In *Jefferson Lines*, this Court provided a reasoned analysis of why application of the external consistency test is fundamentally different for a sales tax and a gross receipts tax. The Court explained that a sale is "a discrete event facilitated by the laws and amenities of the place of sale" that is "wholly local." 514 U.S. at 186-88. Thus, the state in which the sale occurs has an economic justification to tax the entire gross receipts derived, even though interstate events may contribute to that value. *Id.* at 188-89.

In contrast, gross receipts taxes "diverge crucially [from sales taxes] in the identity of the taxpayers and the consequent opportunities that are understood to exist for multiple taxation of the same taxpayer." *Id.* at 190. As stated by this Court, a gross receipts tax is "simply a variety

of tax on income, which [i]s required to be apportioned to reflect the location of the various interstate activities by which it was earned." *Id.* Proof that the Township's BPT is such "a variety of tax on income" is in the very language of the Ordinance, which defines "gross receipts" as any "cash, credits, property of any kind or nature, received or allocable or attributable to any business." Ordinance § 1.04, 60a. The Township's BPT thus fully merits the *Jefferson Lines* analogy to the unapportioned gross receipts tax struck down in *Central Greyhound*.

The Township contends that in quoting portions of this Court's opinion from *Jefferson Lines* that do *not* refer to sales taxes, state courts have somehow undermined "an entire line of this Court's cases specifically upholding unapportioned gross receipts taxes." Pet. at 9. The cases cited by the Township do not support its contention. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987), and *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560 (1975), each involved a tax imposed upon the activity of wholesaling which was assessed only upon the sales activities of the out-of-state taxpayer that occurred within the taxing state of Washington. Unlike the Township here, Washington never asserted that it could reasonably impose its tax upon the gross receipts of the taxpayer attributable to sales activities in other states. Instead, Washington stood in the position of Delaware, Maryland, or New Jersey in this case, asserting its constitutional right to tax that portion of Northwood's gross receipts attributable to the company's business activities within that jurisdiction.

The gross receipts taxes in the other cases cited by the Township also are quite different from that presented here.

The services that were taxed in *Department of Treasury v. Ingram-Richardson Mfg. Co.*, 313 U.S. 252, 255 (1941), and *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938), were performed entirely within the taxing states and involved only incidental interstate activity. In stark contrast, the Township taxes 100% of Northwood's gross receipts from construction activities that occur wholly outside Pennsylvania. The Township never attempts to explain how the Ordinance can pass muster under the external consistency test in light of this undisputed fact.

The Pennsylvania Supreme Court correctly held that the Township is plainly taxing revenues out of all proportion to the value contributed to Northwood's business by the in-state activity being taxed – the privilege of maintaining an office in the Township – and thus has violated the fair apportionment prong of *Complete Auto*. 30a-31a. The Township has provided no justification for this Court's review of that determination.

B. The Pennsylvania Supreme Court Properly Left the Local Taxing Authority Broad Discretion To Establish Any Apportionment Formula That Reasonably Reflects the Local Component of the Activity Being Taxed.

In crafting a second question presented that poses an undisputed point of law, *see* Pet. at i, 11, the Township distorts the facts of this case, the holding of the Pennsylvania Supreme Court, and this Court's precedents concerning apportionment formulas. The Pennsylvania Supreme Court did not ignore the provisions of the Ordinance or mandate any specific apportionment formula for the Township to follow. The court merely held: (1) that Township failed to

apply any apportionment formula to Northwood, and (2) that the Ordinance is unconstitutional unless it applies *some* constitutional formula in order to satisfy the fair apportionment test of *Complete Auto.*

Northwood has never argued in this case that the Township is required to use a particular apportionment formula or method. Northwood's position rather has been that the Township may not tax 100% of the gross receipts it earns outside Pennsylvania without violating the Commerce Clause. *See* 18a, 39a, 48a. The Township takes the contrary position that no matter how much of a taxpayer's gross receipts are generated in interstate commerce, no apportionment is required unless the taxpayer has multi-state offices. Pet. at 11. Following this argument to its logical conclusion, even if a taxpayer had an actual physical presence[3] in other states through which it conducted 100% of its business in those states (*i.e.*, it engaged only in interstate commerce), because the taxpayer lacked a *bona fide* office in the other states the Township would still be entitled to tax 100% of its gross receipts.

The Pennsylvania Supreme Court correctly disagreed with the Township's position that Northwood's maintenance of a primary business office in the Township permits it to tax Northwood's total receipts for activities which take place to a substantial extent outside Pennsylvania. 30a; *see Central Greyhound,* 334 U.S. at 660. This holding by no means stripped the Township of the "wide latitude" granted to local taxing authorities in fashioning apportionment formulas. *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 274 (1978). The court merely concluded in accord with this Court's

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[3] *See Quill Corp. v. North Dakota,* 504 U.S. 298, 311-12 (1992).

precedents that the Township must at least apply an apportionment formula with a "factor or factors [which] actually reflect a reasonable sense of how income is generated." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983).

The Township argues that the Exclusionary Provision of its Ordinance made apportionment unnecessary, since it ensured that multiple taxation would not occur. Pet. at 12. As the Pennsylvania Supreme Court recognized in rejecting this argument, this Court's precedents make clear that, for the purpose of external consistency, apportionment obligations are not satisfied by merely eliminating the risk of multiple taxation. 30a, *citing Jefferson Lines*, 514 U.S. at 185. Moreover, as the court also noted, the Township has *not* excluded from Northwood's taxable gross receipts any receipts upon which taxes were paid to other states. 27a n.18, 30a n.19. Despite stipulating that Northwood paid either gross receipts taxes or net income taxes to other states, the Township contends that these taxes were not "business privilege tax[es] or similar tax[es] ... imposed by another political subdivision by reason of the performance of the service or conducting of business in the political subdivision" so as to trigger the Exclusionary Provision. Pet. at 5, 27a n.18. Ironically, the Township has interpreted the language of its Ordinance so that, as applied, it does not even pass the internal consistency test.

In short, the Pennsylvania Supreme Court rightly rejected the Township's attempt to justify its total lack of apportionment as to Northwood, noting this Court's precedent that "the central purpose behind the apportionment requirement is to ensure that each state taxes only its fair share of an interstate transaction." *Goldberg*, 488

U.S. at 260, *quoted at* 29a. The court correctly held that the Township's assessment of its BPT upon 100% of Northwood's gross receipts from all interstate activities, with no apportionment, does not "reasonably reflect[] the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262, *quoted at* 30a.

CONCLUSION

Because the Pennsylvania Supreme Court correctly interpreted this Court's precedents in determining that the Township's unapportioned Business Privilege Tax was unconstitutional since it did not satisfy the external consistency test of *Complete Auto*, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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